



August 11, 2006

SUMMARY OF INITIATIVE 920 TO THE PEOPLE

Concerns estate tax.

*This summary has been prepared in response to specific questions about the provisions and effects of I-920 and is provided for legislative purposes only; it is **not** provided as an expression for or against the ballot measure. Please remember that it is inappropriate to use public resources to support or oppose a ballot measure. Please refer to pages 22-25 of the 2005-06 Legislative Ethics Manual or contact Senate Counsel for further guidance on when and how comment on ballot measures is appropriate.*

BRIEF SUMMARY

Initiative 920 (I-920) repeals the estate tax passed by the legislature during the 2005 legislative session in ESB 6096. This bill enacted a stand-alone estate tax for Washington after the Supreme Court held in *Hemphill v. Dep't of Revenue* that the estate tax was a "pick-up" tax and not an independently operating estate tax. In effect, the court held that Washington's estate tax must fully conform to the changes in the federal tax law made in 2001 and invalidated the state tax to the extent it exceeded the federal tax credit.

Revenues received from the estate tax are deposited into the Education Legacy Trust Account. Funds from this account are used only for deposit into the student achievement fund and for expanding access to higher education through funding for new enrollments and financial aid, and other educational improvement efforts.

Because of the timing of the effective date of the initiative, the repeal of the estate tax will not reduce the revenues going into the Education Legacy Trust Account in the 05-07 biennium. In the 07-09 biennium, the reduction to the Education Legacy Trust Account will be approximately \$184 million. In the 09-11 biennium, the reduction in the Education Legacy Trust Account will be approximately \$223 million.

BACKGROUND

History

In 1981, Initiative 402 repealed the state inheritance tax and replaced it with an estate tax equal to the amount allowed as a "credit" against the federal estate tax. (The federal government imposes a tax on the transfer of property at death.) The "credit" reduces an estate's total federal estate tax due and transfers the amount of the credit to the state. In this way, states are able to receive their estate tax while not creating any additional tax burden on the estate. This is commonly referred to as a "pick-up" tax—the state is "picking up" the amount that is credited against the estate's federal tax obligation. As a result, the state obtains estate tax revenues without having to impose its own separate estate tax.

When originally approved by the voters in 1981, Initiative 402 incorporated the federal Internal

Revenue Code "as it is amended from time to time." Because the state is constitutionally prohibited from delegating its legislative authority to the federal government, the legislature amended Initiative 402 in 1990 to refer to the Internal Revenue Code "as it existed on June 7, 1990." The Legislature last amended Washington's estate tax law to conform to federal law as of January 1, 2001.

Later in 2001, Congress passed the federal Economic Growth and Tax Relief Reconciliation Act (EGTRRA) which increased the federal estate tax filing threshold and ultimately phases out the federal estate tax by 2010. EGTRRA also reduced the credit allowed for state taxes by 25 percent per year beginning in 2002. Under EGTRRA, the federal government does not allow a credit for state estate taxes paid beginning in 2005. In other words, if no changes are made to federal law, the federal estate tax filing threshold reverts back to 2001 levels and the states would once again be able to take a credit against the federal estate tax.

Because the state tax was specifically tied to the federal law as of January 1, 2001--before Congress passed EGTRRA--the state Department of Revenue continued to collect the state tax under the law as it existed on January 1, 2001. In 2002, bills were introduced in the Legislature both to fully and partially conform state law to the changes EGTRRA made in the federal estate tax. None of these bills passed.

On February 3, 2005, in *Hemphill v. Dep't of Revenue*, the state Supreme Court held that Washington had a "pick-up" estate tax and not an independently operating Washington estate tax. In effect, the court held that Washington's estate tax must fully conform to the changes in the federal tax made by EGTRRA in 2001 and invalidated the state tax to the extent it exceeded the federal tax credit allowed.

The Estate Tax

ESB 6096, enacted by the legislature in the 2005 legislative session, enacted a stand-alone estate tax in Washington independent of and unaffected by federal law. The tax is imposed on the transfer of property located in Washington at the time of death of the owner. The tax rates range from 10 percent to 19 percent of the Washington taxable estate. The Washington taxable estate is equal to the federal taxable estate, determined without regard to the repeal of the federal estate tax and the deduction for state estate taxes, less:

- 1) \$1.5 million for persons dying in 2005 and at \$2.0 million for persons dying in 2006 and thereafter.
- 2) The value of qualified farm property, including the value of any tangible personal property used primarily for farming purposes on the farm.

To be qualified farm property, 50 percent of the estate must be property used for farming, the decedent or decedent's family must have materially participated in the operation of the farm, and the property must pass to a family member. However, no requirement of continued use for farming is placed on the heirs, and special valuation need not be elected for federal purposes.

After all deductions are made from Washington's taxable estate value, the remaining taxable estate value is multiplied by the appropriate Washington estate tax rate. All revenue generated from the tax is deposited into the Education Legacy Trust Account. Funds from this account are

used only for deposit into the student achievement fund and for expanding access to higher education through funding for new enrollments and financial aid, and other educational improvement efforts.

SUMMARY OF I-920

Initiative 920 repeals the Washington state estate tax for decedents dying on or after December 7, 2006.

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This summary should not be considered legislative history for purposes of interpreting I-920.